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August 4, 2008

Mr. L. Dwight Floyd
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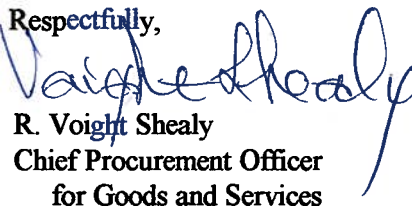
Re: **DECISION**
IN THE MATTER OF: Contract Controversy
Statewide Contract for Unleaded Gasoline - Transport
Contract Number: 07-S7489
Case Number: 2008-122

Dear Mr. Floyd:

Please find enclosed the Decision of the Chief Procurement Officer concerning the administrative review held on July 23, 2008, relative to the referenced matter.

If I can be of assistance to you in this matter, please let me know. Also, please note that a copy of this Decision has been posted today on the sixth floor of the Materials Management Office, 1201 Main Street, Columbia, South Carolina.

Respectfully,


R. Voight Shealy
Chief Procurement Officer
for Goods and Services

enclosure

cc: Keith McCook, Assistant General Counsel
Frank Potts, Assistant General Counsel
John Stevens, State Procurement Officer
Allen Register, Senior Procurement Manager
Cooper Marlowe, Procurement Manager
Jeff McCormack, State Fleet Management
Rob Malpass, State Fleet Management
Mark R. Harper, CEO, United Energy

STATE OF SOUTH CAROLINA)	BEFORE THE CHIEF PROCUREMENT OFFICER
COUNTY OF RICHLAND)	
)	DECISION
In the Matter of Contract Controversy of:)	
United Energy Distributors, Inc.)	CASE NO. 2008-122
)	
v.)	
)	
Materials Management Office)	POSTING DATE:
IFB No. 07-S7489)	
<u>Unleaded Gasoline Transport</u>)	AUGUST 4, 2008

This matter is before the Chief Procurement Officer (CPO) pursuant to a request for resolution of a contract controversy from United Energy Distributors, Inc. (United Energy). With this invitation for bids (IFB), the Materials Management Office (MMO) procured unleaded gasoline in transport quantity as a statewide term contract. MMO awarded United Energy the contract on June 21, 2007. In a letter dated June 16, 2008, United Energy requested the CPO's assistance in resolving a contract controversy with MMO regarding United Energy's request to provide gasoline blended with ethanol (oxygenated fuel) to state and local agencies under the contract. Alternatively, United Energy responded with price increase requests. MMO denied both requests. United Energy argues that without authorization to deliver gasoline blended with ethanol, or, in the alternative, raising its price, it is losing money due to significant increases in diesel gasoline prices which have affected its cost to deliver the gasoline. United Energy asked the CPO to settle the matter, advising the CPO that if the request is not resolved in its favor, it will exercise its right to terminate the contract at the end of the current contract year.

In order to resolve the matter, the CPO conducted a hearing pursuant to the *S.C. Code Ann.* § 11-35-4230 on July 23, 2008. Appearing before the CPO were United Energy, represented by Dwight Floyd, Esq., and Mark Harper, Chief Executive Officer, and MMO, represented by John Stevens, State Procurement Officer.

Efforts were made to resolve the matter prior to the hearing, but they proved unsuccessful.

NATURE OF THE CONTROVERSY

United Energy's request for resolution is attached and incorporated herein by reference.

FINDINGS OF FACT

On May 30, 2007, MMO published IFB No. 07-S7489 [Ex. 1] entitled Statewide Contract for Unleaded Gasoline Transport. The scope of the solicitation was "to establish a statewide term contract for the provision of unleaded gasoline (to include regular, mid-grade, and premium) in transport quantities of 7,500 or more gallons to governmental units throughout the State of South Carolina." [Ex. 1, p. 3] MMO wrote further, "The fuel covered by this bid notice must meet ASTM Specification #D-4814-95B and any applicable ASTM Specification during this contract term." [Ex. 1, p. 11, ASTM] In the bidding schedule, MMO wrote, "UNLEADED GASOLINE, TRANSPORT, MEETING ASTM SPECIFICATIONS D4814-95B, ZONE 1" and "ZONE 2." [Ex. 1, p.21] Bidders were asked to bid a margin or mark-up that they would charge the state above the price of the gasoline itself.

On June 8, 2007, MMO published Amendment No. 1. That amendment was of no consequence to the matters to be resolved here.

On June 14, 2007, MMO opened the bids received. United Energy submitted a bid committing to "be bound by the terms of the solicitation." [Ex. 3]

On June 21, 2007, MMO posted a notice of Intent to Award Zones 1 and 2 to United Energy, the low bidder at a mark-up price of \$0.0095 per gallon. [Ex. 5]

In late September 2007, according to Mr. Harper, United Energy approached MMO regarding the delivery of an ethanol blended gasoline under the contract. He stated that United Energy interpreted the solicitation to allow for delivery of gasoline/ethanol blended gasoline without the state's consent, but chose to

not to do that, desiring instead to mutually agree to this option.¹ In the alternative, United Energy requested a price increase. MMO took no action on United Energy's requests.

The written record of the discussions between United Energy and the state began in May 2008. On May 20, 2008, in an email to Cooper Marlowe, MMO Procurement Manager, Mr. Harper wrote:

We have been discussing the introduction of ethanol blended gasoline since October of 2007. We have offered to clean the tanks for the 4 state agencies that purchase gasoline under this contract as an inducement to make the conversion, and to replace the filters and provide the appropriate water detection paste. To date this offer has not been accepted.

Yesterday, I mailed the attached letter to the non-state entities that purchase gasoline under this contract. As we have shared with you, it is United Energy's view that gasoline blended with 10% ethanol meets the ASTM specifications called for in the contract. We plan to begin supplying these non-state entities with gasoline blended with 10% ethanol beginning on June 2, 2008. In advance of that we will be visiting each location, checking the storage tanks for water, replacing the dispenser filters, and providing new water detection paste for the entities to use in monitoring the water levels in their tanks.

Next week I will be mailing you a proposal to change the price mark-up for this contract. As I shared with you in our last meeting, the cost of delivering fuel is way beyond what was anticipated when we submitted our bid. Our intent will be to honor the current mark-up on all deliveries containing 10% ethanol and only charge the higher mark-up we agree upon on deliveries of conventional gasoline. [Ex. 7]

United Energy did not wait for a formal approval from MMO, but took unilateral action to deliver blended gasoline to local agencies. A letter dated May 19, 2008 to Aiken County, as an example of letters sent to all local governments, was attached to the email and reads in part:

You currently purchase gasoline from United Energy Distributors, Inc. under the terms of our contract with the State of South Carolina.

Under the terms of our agreement with the State, the fuels we deliver are required to meet the most recent ASTM specification which is ASTM #D-4814-06a. Gasoline blended with ethanol meets this specification.

Commencing on June 2, 2008, we will begin delivering gasoline blended with ethanol to you. Since the existing Statewide Gasoline contract anticipated the integration of ethanol blended fuels, the bid factor will remain the same. While this product is delivered and handled in the same manner as conventional gasoline, it does require some minor changes to the filters on your dispensers and requires you to be diligent in managing the water in your storage tanks. Prior to making our first delivery to you, our service technicians will visit each of your fueling location(s), measuring the water levels currently in your tank, and changing or providing a

¹ There is no written record of these discussions. Actually, the first written record of the discussion did not occur until May 2008.

special filter that is sensitive to water and pure ethanol. If the water level is excessive we will meet with you to discuss the removal of the water. In addition we will provide you with a tube of water detection paste for your use in the continued monitoring of water levels. [Ex. 7, attachment]

According to MMO, the delivery of blended gasoline to state or local government facilities was never approved.

On May 27, 2008, Mr. Harper wrote Mr. Marlowe stating, "Pursuant to the terms of the referenced contract, United Energy Distributors, Inc. hereby requests approval of a Price Adjustment due to significantly increased costs. We propose to adjust the price Mark-up in the contract from \$0.0095 per gallon to \$0.0295 per gallon [an increase of 210%], with an effective date of June 1, 2008. This adjustment is necessitated by the higher cost of diesel fuel used by United Energy Distributors, Inc. and its common carriers in making deliveries under the contract." Mr. Harper justified the increase request writing "since that time [bid opening] diesel prices have increased by \$1.722 per gallon (62.4%)...." Mr. Harper reiterated United Energy's offer to deliver blended gasoline to the state at no additional charge.

On May 30, 2008, Mr. Marlowe responded to Mr. Harper writing, in part:

We do not agree to the proposed changes in the terms and conditions including the offer to provide a substitute product.

The rejection of the offer applies to orders from all contract users. State agencies are not authorized to accept the substitute product and political subdivisions must expressly (in writing) agree to accept same. United Energy may not compel any contract user (state agency or political subdivision) to accept the substitute product. Any attempt to deliver the substitute product to a state agency or compel a political subdivision to accept the substitute product will be a material breach of the contract. Furthermore, refusal to fully perform the contract for any order placed pursuant this contract (deliver the specified product at the terms and conditions listed in the contract documents) will also be considered a material breach.

United Energy has clearly stated its position that the gasoline blended with 10% ethanol meets ASTM specification D4814, which is referenced in the contract documents. At this time, the State does not express an opinion concerning whether or not the proposed substitute product meets the ASTM standard referenced. However, the State is in full agreement with the well-established premise that ASTM standards are not used to define a product. They are used as quality standards. The current statewide contract for unleaded gasoline transport was positioned to address the State's needs for conventional unleaded gasoline. It does not contemplate ethanol blended fuels. The State considers E10 and conventional unleaded

gasoline to be two different products. As United Energy has previously acknowledged, there are many characteristics that separate the two products. These include but are not limited to octane rating, fuel mileage, effect on vehicle filters, effect on storage tanks, and effect on particulate emissions.

The State understands that there are certain benefits to using ethanol blended fuels. We have also received information that ethanol blended fuels will soon replace conventional unleaded gasoline at the terminals. However, at the present time, we have received no communication from users of this contract or any other gasoline contract indicating that there is immediate demand for ethanol blended product. Additionally, the Spartanburg and Charleston terminals have not yet begun to post prices for E10 (Gasoline blended with 10% ethanol).

Therefore, while the State understands that it must address this issue in the near future, our position is that doing so at this point is premature. At such time as it is appropriate to do so, the State will establish a separate contract for E10. This will happen once E10 pricing at the terminal level is more available, customers express interest in purchasing the product, and the State has conducted sufficient research and evaluation to position a contract for this commodity. This approach gives our customers options in their fuel purchasing, and also allows them time to make this transition based on their own schedules and best interests of the individual entity. [Ex. 9]

On June 11, 2008, Mr. Harper requested approval of the price increase of \$0.020 per gallon from Mr. Marlowe. He wrote, "If you are unable to communicate the approval by that time [June 13, 2008], we reserve our right to terminate the agreement as provided for in the contract, even if that means providing less than the 90 days notice required by the contract." [Ex. 10]

On June 12, 2008, Mr. Cooper responded to Mr. Harper writing, "One litmus test that the State Procurement Office uses in evaluating price increase requests is to determine whether the proposed increased price exceeds the next low bid(s) from the relevant solicitation. In this case, the increased price that United Energy has requested – a price mark-up of \$0.0235 – exceeds several other bids we received pursuant to this solicitation. It is due to this fact that the State Procurement Office hereby elects to decline United Energy's request for a price increase." [Ex. 11]

On June 16, 2008, United Energy filed its request for resolution of the contract controversy with the CPO.

On June 17, 2008, United Energy wrote to the CPO, “Given the State’s insistence upon its current interpretation of the Contract, United Energy simply cannot continue to provide under the Contract after September 15, 2008 . . . Therefore, please consider this letter United Energy’s timely and formal notice under the terms and conditions of the Contract of its election to terminate the Contract at the end of the current term . . . If the dispute is fully resolved before the end of the term, United Energy will gladly withdraw this notice if Election to Terminate and continue for another term.”

DETERMINATION

Two distinct issues surround this controversy: 1) Did the solicitation allow for delivery of blended gasoline? and 2) Did MMO act arbitrarily in denying United Energy’s price increase requests?

1) Did the solicitation allow for delivery of blended gasoline?

United Energy’s primary argument is that the IFB allowed bidders to bid either conventional (unblended) gasoline or blended (oxygenated) gasoline with up to 10% ethanol (commonly referred to as E10). MMO disagrees, arguing that the IFB solicited bids for conventional gasoline only; not blended alternatives.

Regarding the delivery of blended gasoline, the solicitation documents do not address blended versus conventional gasoline expressly. The description of the IFB reads “unleaded gasoline.” [Ex.1, p. 1] The scope of the solicitation reads, “Unleaded gasoline.” [Ex. 1, p. 3] MMO contends that it solicited bids for conventional gasoline, not blended gasoline and that had it desired bids for blended gasoline, the IFB would have specified blended fuels.

MMO notes that conversion to blended gasoline requires alteration of the state and local government fueling sites, an expense not considered in the competitive process that could have altered the outcome of the

IFB. At no more than a 10% ethanol blend, generally, retrofitting of vehicles is not required (at 20% ethanol retrofitting is necessary). However, even at a 10% blend, certain adjustments must be made to fueling sites and their underground storage tanks. Each tank must be inspected for water. If two or more inches of water is discovered in a tank, the tank must be drained and cleaned. Fill covers, the fill hole, and the field around the fill hole may be required to be modified. A particulate foaming filter, which is water sensitive, must be installed at every fueling site.

According to Mr. Harper, United Energy relied upon the IFB's reference to ASTM specification #D-4814-95B and bid intending to supply blended gasoline. He argued that ASTM specification #D-4814-95B, and its contemporary successor #D-4814-06a, cover both conventional gasoline and blended gasoline; therefore the IFB allowed bidders to bid either conventional or blended gasoline. He testified that after reading the ASTM specification, he bid believing blended gasoline to be allowed by the IFB. He argued further that United Energy had the right to deliver blended gasoline to the state and local agencies without informing MMO, but that he felt compelled to notify MMO of his intention after United Energy received the award.²

Where United Energy has a problem with attempting to say that the phrase "unleaded gasoline" includes E-10 gasoline is that the ASTM distinguishes between the two. The ASTM makes the statement at paragraph 5.5 that "[t]he properties of gasoline-oxygenate blends can differ considerably from those of gasoline." E-10 is a gasoline-oxygenate blend and if that is what the State was soliciting it would presumably have said so. As the ASTM notes, it does not necessarily include all types of fuel that are satisfactory for automobiles nor does it exclude them. It addresses "gasoline and its blends with oxygenates, such as alcohol and ethers." ¶ 1.3. It does exclude fuels that contain oxygenates which are the primary component such as M-85. If the State were seeking an ethanol blend in a solicitation, it would probably want to reference a standard such as ASTM D-4806 for denatured fuel grade ethanol for blending with gasoline.

There is one statute in South Carolina which does appear to help and it is a tax statute. The *S.C. Code Ann.* § 12-28-110 defines “Motor Fuels Subject to User Fees”. The statute defines “Blended Fuel” as “a mixture composed of gasoline or diesel fuel and another liquid, other than a de minimis amount of a product such as a carburetor detergent or oxidation inhibitor, that can be used as a fuel in a highway vehicle.” § 12-28-110(3). This would clearly include within its definition the E-10 blend. Also included in its definitions is “Gasohol” which is defined as “blended fuel composed of gasoline and fuel alcohol.” §12-28-110(27).

According to Mr. Harper, when he received the IFB, he read the ASTM specification referenced in the IFB and decided it could be interpreted to allow bidders to supply a blended gasoline. This is a patent ambiguity in the solicitation.³ However, he did not ask or raise the question before submitting United Energy’s bid. Had he asked, this matter would not be before the CPO today. He proceeded with a bidding strategy of intending to supply a blended fuel to the state in spite of the fact that the IFB did not address blended gasoline at all and that every state and local agency fueling location would have to be modified to accommodate the blended gasoline.⁴

Therefore, United Energy’s request is denied.⁵

Although not intentional, some ambiguity occurred in this solicitation. Mr. Harper speculated that three bidders bid as he did; intending to supply blended gasoline. However, according to him, others did not. Assuming Mr. Harper’s own argument, it seems the best approach to rebid the gasoline and eliminate any and all ambiguities in the IFB.

² To deliver a blended gasoline (such as E-10) to the State and its political subdivisions without notice could have been a disaster causing significant damage to all concerned. The idea of delivery of E-10 to conventional gasoline stations without notice is not realistic due to the probable resulting damage.

³ The solicitation makes clear that an “[o]fferor assumes responsibility for any patent ambiguity in the Solicitation that Offeror does not bring to the State’s attention.” DUTY TO INQUIRE (JANUARY 2006)

⁴ Mr. Harper proceeded with his bidding strategy because it afforded United Energy (and possibly the State) a better price. The Federal government offers a tax credit of \$0.51 for the purchase of every gallon of pure ethanol. At a mixture rate of ten percent proposed by United Energy, United Energy would receive a tax credit of \$0.051 per gallon of blended gasoline delivery to the state and local agencies. The tax credit itself dwarfs the mark-up offered by United Energy of \$0.0092.

⁵ According to Mr. Harper, a patent ambiguity may have existed in the solicitation in that besides his company, three other bidders offered rates which supported a margin that implied that they too believed that blended gasoline could be provided under the contract. However, several other offerors did not and according to their bids they clearly understood that only conventional unleaded gasoline was sought.

The gasoline market is evolving; moving toward blended gasoline. According to testimony, 30% of the gasoline sold in the United States is blended gasoline. California allows only sales of blended gasoline because it is better for the environment. MMO should study its gasoline purchasing practices and consider accepting bids for blended gasoline during its resolicitation.

2) Did MMO act arbitrarily in denying United Energy's price increase requests?

The subordinate issue before the CPO is whether MMO should have allowed United Energy a price increase. United Energy pursued a price increase in September 2007, a scant three months after the bids opened. Officially, United Energy requested the price increase due to the increase in diesel fuel prices necessary to delivery the gasoline to the state's fueling facilities. Actually, however, United Energy primarily sought delivery of blended gasoline, which it intended to deliver to the state all along. United Energy only requested the price increase if MMO refused to accept blended fuel, which the IFB did not expressly allow.

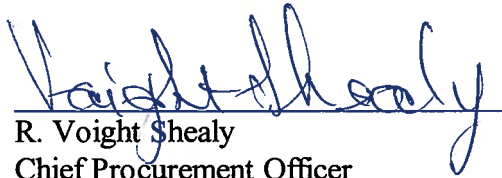
United Energy's bidding strategy is apparent in its requests for price increases. As Mr., Harper wrote Mr. Marlowe, "As I shared with you in our last meeting, the cost of delivering fuel is way beyond what was anticipated when we submitted our bid. Our intent will be to honor the current mark-up on all deliveries containing 10% ethanol and only charge the higher mark-up we agree upon on deliveries of conventional gasoline." [Ex. 7] While he spoke of a price increase, his real target was approval from MMO to deliver blended gasoline instead. He wrote Mr. Marlowe again, stating, "Since the existing Statewide Gasoline contract anticipated the integration of ethanol blended fuels, the bid factor will remain the same." Finally, Mr. Harper acknowledged that there are differences in how blended gasoline must be handled in that he wrote, "While this product is delivered and handled in the same manner as conventional gasoline, it does require some minor changes to the filters on your dispensers and requires you to be diligent in managing the water in your storage tanks."


Mr. Harper reiterated at the hearing United Energy's offer to deliver blended gasoline to the state at no additional charge.

The IFB required, "Any pricing provided by contractor shall include all costs for performing the work associated with that price. Except as otherwise provided in this solicitation, contractor's price shall be fixed for the duration of this contract, including option terms." [Ex. 1, p. 14, Fixed Pricing Required] At best, United Energy was authorized to request a price increase during the life of the contract. However, MMO clearly reserved the right to accept or deny such price increase request.

The primary issue before the CPO is whether or not blended gasoline would be accepted by the state, not whether United Energy is due a price increase on conventional gasoline. United Energy's requested price increase was 210%, an astronomical percentage increase that would cost state and local agencies an additional \$57,200. MMO was entirely within its rights to accept or deny any price increase requests from United Energy.⁶ MMO exercised its right to deny the request. United Energy exercised its right to terminate this contract at the end of the initial term. Neither side acted arbitrarily.

Therefore, the request of United Energy is denied. United Energy's termination of the contract is accepted.


R. Voight Shealy
Chief Procurement Officer
for Supplies and Services


Date

Columbia, S.C.

⁶ Any such price adjustments are subject to the terms of the solicitation and the State's refusal to agree to the same was clearly justified. See PRICE ADJUSTMENTS (JANUARY 2006)

STATEMENT OF RIGHT TO FURTHER ADMINISTRATIVE REVIEW

The South Carolina Procurement Code, in Section 11-35-4210, subsection 6, states:

(6) Finality of Decision. A decision pursuant to subsection (4) is final and conclusive, unless fraudulent or unless a person adversely affected by the decision requests a further administrative review by the Procurement Review Panel pursuant to Section 11-35-4410(1) within ten days of posting of the decision in accordance with subsection (5). The request for review must be directed to the appropriate chief procurement officer, who shall forward the request to the panel or to the Procurement Review Panel, and must be in writing, setting forth the reasons for disagreement with the decision of the appropriate chief procurement officer. The person also may request a hearing before the Procurement Review Panel. The appropriate chief procurement officer and an affected governmental body shall have the opportunity to participate fully in a later review or appeal, administrative or judicial.

Copies of the Panel's decisions and other additional information regarding the protest process is available on the internet at the following web site: www.procurementlaw.sc.gov

FILE BY CLOSE OF BUSINESS: Appeals must be filed by 5:00 PM, the close of business. *Protest of Palmetto Unilect, LLC*, Case No. 2004-6 (dismissing as untimely an appeal emailed prior to 5:00 PM but not received until after 5:00 PM); *Appeal of Pee Dee Regional Transportation Services, et al.*, Case No. 2007-1 (dismissing as untimely an appeal faxed to the CPO at 6:59 PM).

FILING FEE: Pursuant to Proviso 66.1 of the 2007 General Appropriations Act, "[r]equests for administrative review before the South Carolina Procurement Review Panel shall be accompanied by a filing fee of two hundred and fifty dollars (\$250.00), payable to the SC Procurement Review Panel. The panel is authorized to charge the party requesting an administrative review under the South Carolina Code Sections 11-35-4210(6), 11-35-4220(5), 11-35-4230(6) and/or 11-35-4410(4). . . . Withdrawal of an appeal will result in the filing fee being forfeited to the panel. If a party desiring to file an appeal is unable to pay the filing fee because of hardship, the party shall submit a notarized affidavit to such effect. If after reviewing the affidavit the panel determines that such hardship exists, the filing fee shall be waived." 2007 S.C. Act No. 117, Part IB, § 66.1. PLEASE MAKE YOUR CHECK PAYABLE TO THE "SC PROCUREMENT REVIEW PANEL."

LEGAL REPRESENTATION: In order to prosecute an appeal before the Panel, a business must retain a lawyer. Failure to obtain counsel will result in dismissal of your appeal. *Protest of Lighting Services*, Case No. 2002-10 (Proc. Rev. Panel Nov. 6, 2002) and *Protest of The Kardon Corporation*, Case No. 2002-13 (Proc. Rev. Panel Jan. 31, 2003).